



Basic legal framework of the Central Bank of Chile and its functions in the economic Constitutional context

Presentation prepared for the Seminar “Chilean Foreign Exchange and Money Markets. Legal and Regulatory Framework” organized by the Central Bank of Suriname and the Embassy of the Republic of Chile to Suriname.

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Central Bank of Chile, October 2016

Agenda I

Basic Legal Framework of the Central Bank of Chile (CBC).

- **Legal framework of the Central Bank of Chile (CBC). Basic aspects and evolution until it was conferred constitutional autonomy status.**
- **Nature and scope of powers of the Bank in the constitutional context.**
- **New Legal Framework - comparative experience and some figures on Monetary and Foreign Exchange Policies.**
- **Specific constitutional safeguards regarding CBC structure, purpose and functions .**
- **Conclusions.**



Agenda II

CBC Authority and Operations regarding Monetary and Foreign Exchange Markets

- **First Part. Main powers and functions of the Central Bank of Chile (CBC), including Monetary Policy**
- **Second Part. Basics for Foreign Exchange Regulation**
- **Annexes for reference:**
 - 1. Foreign exchange restrictions applied in the past**
 - 2. Measures approved to provide liquidity in local and foreign currency to the Banking System during 2008-2009**



Agenda I

- **Legal framework of the Central Bank of Chile (CBC). Basic aspects and evolution until it was conferred constitutional autonomy status**



First origins

- Created in **August 1925**, Decree Law 486
- Edwin Kemmerer Economic Mission
- Initiated its operations on January 11, 1926
- Gold pattern as the basic foundation of the monetary unit, in order to control inflationary expansion, without fiduciary issuing of currency - fully backed by gold
- **Initial purpose: to provide for the stability of the currency under the gold pattern regime with full convertibility; and regulate the amount of currency in circulation** in accordance with the needs of the monetary market with the **exclusive power to issue banknotes** and coin money. Also **empowered to regulate interest and discount rates**

First origins

- **Final objective:** to avoid disturbances in the financial and industrial development of the Nation and to foster economic progress
- Full convertibility **ended discussions** between those supporting the **gold pattern** and those in favor of controlled **issuance of fiduciary currency to foster the country's export capacity**. The Government was financed with foreign and domestic banking loans and when it was unable to paid, it authorized banks to make private bank notes issues ("**banca libre de emisión**")
- Under the first Act, **the Bank could acquire public** debt up to 20% of its paid up capital and reserves
- The Bank was constituted as a **public legal entity independent from the Government**; Directory: 10 board members, only 3 from the Executive Power and the rest from the private sector; 4 more members were added in 1946 from Parliament...political influence



Origins

- The **gold pattern had limited application**, it did not pass the 30's
- There were **3 more previous Central Bank Organic Acts** regarding legislation actually in force (1953, 1960, 1975)
- Since **1953** the Bank was assigned a **more active role in the development of the economy**. Purpose: *To tend to the progressive and ordered development of the national economy by means of the monetary and credit policy, pursuing to avoid inflationary or depressive tendencies, to allow the greater use of the productive resources of the country*
- Also the **Bank powers were extended** regarding monetary bank reserve requirements and credit controls (qualitative and quantitative)
- During **1980** the Bank was granted the power to **issue general regulations regarding foreign trade and foreign exchange operations**

Origins

- **1975. New purpose for the Bank...***to provide for the orderly and progressive development of the national economy, by means of the **monetary, credit, capital markets, foreign trade and foreign exchange policy instruments provided.** Monetary Council*, integrated by different Ministries, in charge of establishing policies regarding those issues
- Bank **expressly authorized to grant credits to the State Treasury**
- Contemplated as an **autonomous entity of public law**, not being part of the Public Administration, ruled only by its Act, and in its silence by the provisions regulating the private sector
- The **weak institutionality** of the Central Bank in critical aspects avoided to reach the purpose of its original establishment and persisting high inflation rates were observed for decades...one of the problems...lending to Government and the Public Sector
- Then emerges the ***need to establish the grounds for an independent exercise of monetary and foreign exchange policies regarding fiscal policy***, while isolating such policies from the interests and influence of different economic, political and governmental sectors

Nature and scope of powers of the Bank in the Constitutional context



The need for a transition to a new institutionality...in figures

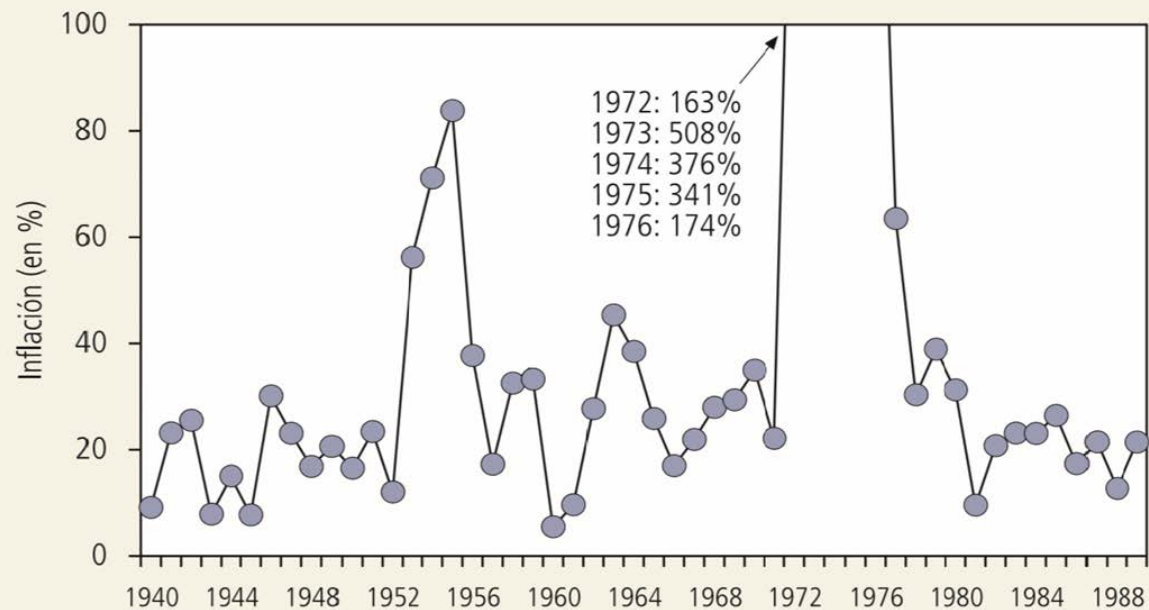
- 1940-1980, annual average inflation rate: 43%. Decades; 40's, 18%; 50's, 36%; 60's, 24%; 70's, 174%.
- Inability to cope with the effort of reducing inflation to a tolerable level, notwithstanding the recognition of its harmful consequences.
- Replacing of the monetary sign, 1958 and 1975 Laws, **\$1000 old pesos=1 “Escudo”**; then after **1000E=1 \$ peso nuevo**, buying power of new peso represented 1/1.000.0000 value of 1 old peso (A. Bianchi, 2009).



Inflation data 1940-1989. INE

GRÁFICO 1

Inflación en Chile, 1940 - 1989
(variación IPC diciembre a diciembre)



The need for a transition to a new institutionality...in basic economy

- For economic science, **inflation represents a monetary phenomena, determined by the continuous increasing of the prices levels of the economy**, measured by a given price index. The amount of money in circulation plays a decisive role, demonstrated in the prices of goods and services resulting from transactions of such economy.
- **Entrusting the capacity to regulate the monetary volume in circulation to a political power that** includes financing of public expenditure by the CBC, harmfully links the monetary policy to the **political-economic cycle**, as a proven **source of chronic inflation**.



The Bank and the 1980's Political Constitution of the Republic

- Such circumstances determined during the discussion and drafting of the 1980's Political Constitution of the Republic (CPR) the convenience to ***provide directly in its provisions the establishment of an autonomous and technical entity empowered to adopt decisions independently, mainly regarding monetary and foreign exchange issues, separating such policies from the fiscal policy***. Such purpose was achieved
- The Organic Constitutional Act (the Act), that enforced such institutionality fulfilling the constitutional mandate, was issued in 1989



The Bank in the Constitution

- A public law (*derecho público*) institution enshrined in the Constitution (CPR)
- Autonomous, and
- Of technical nature
- With its own assets and full legal capacity
- Its composition, organization, functions and powers shall be determined by the Act
- In order to modify or abrogate the Act (4/7 of Senators and Lower House members in office are required)



Autonomy vs. Independence

- ***Autonomy its granted to achieve the legal purpose of the Bank and to exercise its powers, regarding other entities of the State,*** under constitutional and legal provisions and subject to jurisdictional control and transparency & ethic behavior provisions
- ***Autonomy not independence,*** “not a state within a state”, subject to accountability and transparency provisions
- ***Constitutional Autonomy*** granted regarding its **capital** (own patrimony); in the **organic** (no other hierarchical power vested over the Bank – SBFI - GCR) and **functional** aspects (exclusive powers)



The Bank in the Constitution

- It is *only able to perform transactions with financial institutions*, either public or private. **In no way whatsoever** may **act as guarantor** for them nor **acquire securities issued by the State**, its agencies or enterprises
- **No public expenditure or loan may be financed through indirect or direct credits of the Bank**
- **Regarding regulatory powers:** The Bank shall be prohibited from adopting any resolution which may result either directly or indirectly in the establishment of **rules or requirements different or discriminatory** with respect to persons that perform transactions of the same nature



Bank Act

- The Bank shall have as its purpose to look after the stability of the currency and the normal functioning of internal and external payments.
- The powers of the Bank, for these purpose, shall include that of regulating the amount of currency and credit in circulation, the performance of credit transaction and foreign exchange, as well as the issuance of regulatory provisions regarding monetary, credit, financing and foreign exchange matters.”



Bank Act

- In accordance with the CPR mandate the Act confers on the Bank ample public authority:

To regulate the amount of currency and credit in circulation,

To perform credit transactions and foreign exchange, and

To exclusively issue regulatory provisions regarding monetary, credit, financing and foreign exchange matters.



Bank Act

- The **Bank purpose** encompasses...
- to look after the **stability of the currency** (maintain its acquisitive power by controlling inflation and avoiding abrupt fluctuations of its value regarding foreign currencies which are deemed not coherent with the exchange rate regime determined by CBC)
- provide for the **normal functioning of payments** (includes payment systems, payment instruments and financial stability)



Bank, Constitution and Act

- Based on the foregoing:
The Bank is an autonomous institution - from public authorities of the State of Chile - in the fulfillment of public duties conferred by the Act;
The Bank is not subordinated to any other public authority to undertake its legal mandate, but to the CPR and the Bank Act that provides for its composition, organization, duties and powers (also accountable under said framework); and



Bank, Constitution and Act

- The Bank is **the only entity empowered** to issue general regulatory **provisions regarding monetary, credit, financing, and foreign exchange** matters
- **Coordination issues:** The Bank Council (Board) when passing its resolutions shall consider the general orientation of the Government economic policies
- There are **other ways of coordination with the Executive Power** (mainly through the Minister of Finance) - while preserving the Bank autonomy to protect its technical nature
- **Reporting requirements in the Act** (sections 4, 75-80) and transparency provisions (section 8 CPR - sections 65bis-67)



Bank relationship with Executive Power

- **Appointment of the Council members with prior approval of the Senate** (5 members, each nominated for a 10 years period – Presidential period - 4 years)
- **Executive Power lacks the authority to regulate the same issues conferred to the Bank by the Act** (infringement: nullity of the corresponding act without prejudice of administrative liabilities)
- **Dismissal mechanisms of Board members contemplated in the Act**
– mainly by means of an action or accusation from the President of the Republic - before a Court or Senate (sections 15-17)



Bank relationship with Executive Power

- The Act sets forth specific provisions on the Bank's public duty:

Performance of monetary policy considering the general orientation of the government's economic policy

To inform the President of the Republic and the Senate as provided by law in regards to policies and general regulations issued

Advise the President of the Republic , upon his request, in all matters within the scope of its duties



Bank relationship with Executive Power

- Attendance of the **Minister of Finance** to Council meetings with the right to be heard and to propose the adoption of specific resolutions
- Also empowered to **suspend the enforceability of any decision or resolution** passed by the Council for a period not to exceed 15 days, counting from the date of the respective meeting (section 19)
- The Act also confers to the Minister the **right to veto the enforceability of foreign exchange restrictions** contemplated in the Act (section 50)
- **Suspension and Veto; it is possible to supersede** if all Council members in office insist in adopting the decision or resolution



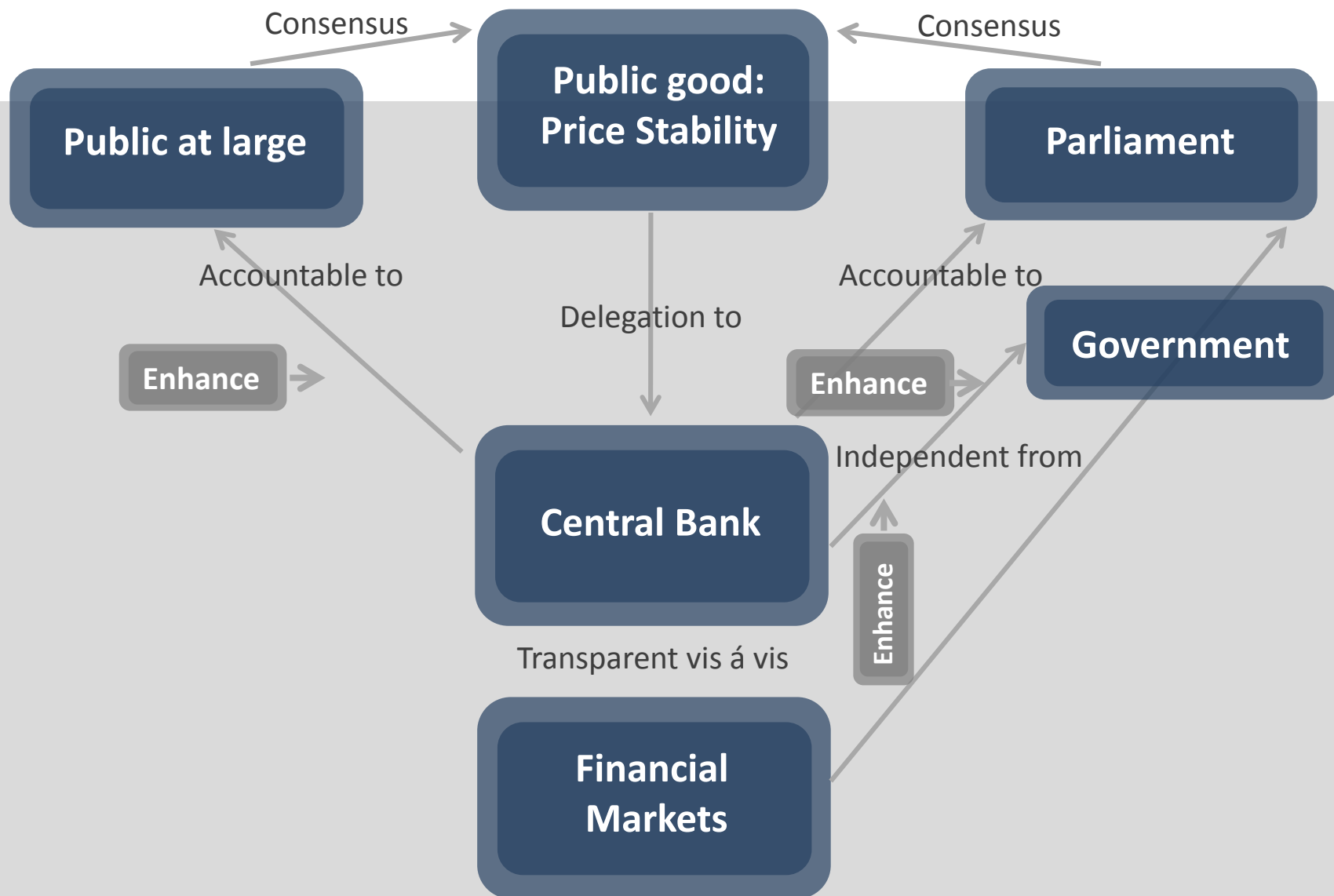
New Legal Framework - comparative experience and some figures on Monetary and Foreign Exchange Policies.



Comparative Experience

- Bundesbank. European Central Bank (ECB – ESCB). Federal Reserve System (FED – Board of Governors _ F.O.M.C.).
- Autonomous regarding monetary policy and in overseeing payment systems. Bank supervision
- Price Stability, priority objectives and inflation targeting in the long term.
- FED. Includes full employment objective.





Policy Lessons From Global Trends

General Consensus Views

- 1.- Set price stability as one of the primary objectives of monetary policy.
- 2.- Restrict direct lending to governments.
- 3.- Ensure full independence for setting the policy rate.
- 4.- Ensure no government involvement in policy formulation.
- 5.- Ensure that accountability corresponds to the level of independence
- 6.-Ensure that transparency corresponds to the level of accountability and financial market deepening



Monetary and Foreign Exchange Policies (MP and FXP) _ During CBC Act

- Annual average inflation rate; **gradual stabilization**.
- **1990. 27,3%**; 91,18,7%; 92, 13%; 94, - del 10%; **98, 4,7%**.
- **1999-2007. 2.8%**.
- **1999. Inflation Targeting Scheme** (3%, +/- 1%, 2 year horizon) y and **free floating exchange rate regime**, the peg system ended (in force since 1984).
- 1990-99. PIB (GDP) 5% annual; unemployment drops from 7,8 to 6,2%.
- **Predictability of MP and FXP; inflation expectative anchoring**, due to enhanced credibility and reputation of CBC, reducing the cost of both policies



Recent performance

2000-2012

Inflation: 3.3%

GDP growth: 4.5%

Multilateral Exchange Rate (ER)= 94.5 ; two ER short CBC interventions

Market interest rate(*): 8.4%

2013-2016

Inflation: 3.6%

GDP growth: 2.6%

Multilateral ER: 95.3, no CB interventions necessary

Market interest rate(*): 7.1%



Specific Constitutional safeguards regarding the Central Bank structure, purpose and functions



The Bank and the Constitution

- ***Essential aspects of the legal nature and scope of powers of the Bank are directly established in the Constitution*** in terms of its autonomy, technical condition and the relationship with the Executive Power; and the non discriminatory exercise of regulatory powers
- ***More flexibility is incorporated in terms of delegating on the Act the determination of specific issues*** connected with its composition, organization and powers. Actually, even its legal purpose its delegated to the Act
- It was believed that such structure should ***ensure due fulfillment of its tasks***, that will necessarily be related by the Act legislator with the tasks that central banks will have to perform in the 80's and **in the future**



The Bank and the (Economic) Constitution

- The Bank institutionality is **part of the system of public bodies and authorities contemplated in the Constitution in order to** fulfill the public purpose of the State (pursuing the **common good**), as a way to exercise sovereignty directly subjected to the **rule of law** and **constitutional supremacy principles** (direct legitimacy)
- Also there is a relationship of the Bank's statute with the set of **individual rights and guaranties** established in the Constitution having an **economic meaning** in the development of such kind of activities
- The powers conferred to the Bank are part of the **juridical concept denominated Public Economic Order**, to regulate and supervise certain economic activities, in accordance with public interests committed



Public Economic Order

- Juridical concept of undefined content...its specific content is defined in each epoch. One of the most used doctrine definitions considers that the Public Economic Order (PEO) entails “**the set of principles and juridical regulations that organize the economy of a country and empowers the authority to regulate it in harmony with the Nation’s values enshrined in the Constitution**” (José Luis Cea, 1988)
- Under the 1980’s Constitution the PEO ***guarantees the right to undertake any economic activity*** which is not contrary to morals, public order or national security, ***abiding by the legal rules which regulate it.***
- Also, in this context the State entrepreneurial activities are restricted to exceptional circumstances, expressly authorized by laws of qualified quorum, being also subject to the common legislation applicable (Section 19 N°21).



Public Economic Order

- **Other individual rights and freedoms related** .. freedom to work and its protection, right to free contracting, prohibition of arbitrary discrimination in the treatment that the State provides in economic matters; freedom to acquire ownership of all assets; right of ownership; right of author, intellectual property; equal distribution of taxes; etc.
- **Such freedoms and rights are ensured in the Constitution with the possibility to exercise constitutional protection actions** (before the Courts of Appeal); the inapplicability action (Constitutional Court); or the Appeal recourse directly established in the Organic Acts of the supervisory or regulatory bodies
- **Hence, ample regulatory powers conferred to the Bank are part of the scheme of public powers distribution system** contemplated in the Constitution as part of the Public Economic Order, allowing for flexibility in the process of addressing such issues (i.e. regulation regarding non banking entities credit card issuers)



Public Economic Order

- Such **legal powers are limited** by the obligation of the Bank to observe the proper **constitutional and legal provisions**; and also by **the legal purpose of the institution** that circumscribes the scope of its exercise (**Autonomy-Accountability-Transparency**)
- **Regulatory powers are part of a major process of legal “de-regulation”** contemplated in the Constitution, that limits the matters that can be addressed by means of a law – binding regulations of general nature establishing the essential bases of a juridical order -. Also, the ***general regulatory powers conferred to the President of the Republic***, are part of this legislative structure, comprising regulations to execute legislation enacted or to rule in matters not to be covered by law



Concluding remarks

- **The Central Bank institutionality is enshrined in constitutional and specific legal provisions**, specially issued in order to regulate the composition, organization, duties and powers of the Bank
- **Main characteristics...Its constitutional autonomy and technical nature**, regarding the proper fulfilling of its task...**subject to accountability and transparency provisions**
- **The obligation not to discriminate among persons carrying out operations of the same nature**...and to observe individual rights guaranteed by the Constitution...with constitutional and legal actions to ensure due application of the legal framework



Concluding remarks

- **Exclusive powers and duties** conferred in order to ensure currency stability and the normal functioning of the payment system...
- **Ample regulatory powers in monetary, credit, financing and foreign exchange matters**, that form part of the constitutional mechanism that considers granting powers to regulatory and supervisory bodies related with economic activities
- Such institutionality form **part of the Public Economic Order concept in force**





CBC Authority and Operations regarding Monetary and Foreign Exchange Markets Part I



Agenda II

CBC Authority and Operations regarding Monetary and Foreign Exchange Markets

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Main powers and functions of the Bank

Title III CBC Act, articles 27 to 57



Agenda

- The Bank has the exclusive authority to issue banknotes and to coin money

The banknotes and coins issued by the Bank shall be the sole means with an unrestricted discharge effect and power of exchange, shall be legal tender throughout the territory of the Republic, and shall be accepted at their face value



Bank Authority and Operations

- **Monetary Policy:** In order to regulate the amount of currency in circulation and credit, the Bank shall have the authority:

To open credit lines to banking entities, concede refinancing, **discount and rediscount** negotiable instruments;

Establish the **reserve requirements** that, proportionate to their deposits and commitments, banking entities and saving and loans cooperatives must keep under the conditions set forth by the Bank;



Bank Authority and Operations

- **Assign instruments** of its own credit or investment portfolio **to banking entities, and acquire** from the same instruments of their credit or investment portfolio;
- **Issue debt securities**, incorporate its terms and conditions, place and acquire them in the open market
- **Buy and sell debt securities** and commercial paper **in the open market** issued by banking entities



Inflation Targeting _ since 1999

- **Inflation Targeting Scheme. Within a medium term horizon (2 years)** CBC is committed to use the necessary instruments to keep annual Consumer Price Index (CPI) inflation around 3% most of the time, within a tolerance range +/- 1%. Guide expectations of economic agents and makes the midpoint of the target range the economy's nominal anchor
- **Floating exchange rate regime.** Enables the conduct of an independent monetary policy (MP), allowing to absorb external price shocks. Helps to prevent extreme misalignment in the FX rate and speculative attacks on the currency. CBC reserves the right to intervene in exceptional circumstances, based upon justified reasons



MP Meetings and MP Transmission

- In **MP Meetings (MPM)**, normally announced six months in advance, the Council determines the value of **a reference interest rate known as the Monetary Policy Rate (MPR)**, considering future inflation projections.
- **MPM**: Macroeconomic analysis, applying statistical models to main changes on global and domestic economy, and its effects on future inflation projections.
- **MP alternatives**; Evaluate to maintain, rise or reduce MPR.
- **Official Press release and additional transparency measures**; previous disclosure of economic scenario considered; afterwards MPM Minutes and MP Report every Quarter.
- **Implementation of MP objective**, by influencing the daily interbank interest rate for overnight credit between commercial banks; between the supply of and demand for funds or liquidity; influencing the monetary volume, so that the resulting interest rate gets close to the MPR.



MP Transmission

- **Liquidity Demand:** Bank Reserve requirements; interbank obligations
- **Liquidity supply Influence:** Payments on maturities regarding debt securities issued by CBC, new placements
- **CBC Daily operations:**
 - **Providing Liquidity to banks: Permanent Liquidity Facility, with overnight REPOs** (purchase on debt securities with repurchase agreements). Interest Rate: $\text{MPR (3,5\%)} + 25 \text{ bp}$
 - **Liquidity withdraw:** Liquidity Deposits. Interest Rate: MPR (3,5\%) . Liquidity Deposit Facility, overnight. Interest Rate: $\text{MPR (3,5\%)} - 25 \text{ bp}$
- **Daily disclosure of economic statistics on MP**



Financial Sector and Capital Markets Regulation

- The Bank shall have the authority:

To **issue the regulations** which banking entities and saving and loans cooperatives shall follow with respect to **borrowing from the public**

To authorize banking entities to pay interest on banking accounts; and to concede credits associated to banking checking accounts and to allow overdrafts on said accounts;

Establish the maximum interest rate payable by the banking entities and savings and loan cooperatives on sight deposits;



Regulation of the Financial Sector

- To **authorize the establishment and regulate the functioning of clearing houses** for bank checks and other securities in which banks participate;
- Issue the regulations and set the limitations on **collateral and surety matters** denominated in foreign currency to which banking entities must conform;
- Issue the regulations and set the limitations regarding the **ratio that must exist between asset and liability operations**, to banks and saving and loans cooperatives;



Regulation of the Financial Sector

- To issue the regulation to which enterprises having as their purpose the **issuance or operation of credit cards or any other similar method** and which are under the supervision of the Superintendence of Banks and Financial Institutions (SBFI), must conform
- **Authorize adjustment systems** to be used by banking entities and saving and loan cooperatives in their **money credit transactions** in CLP currency

Said powers must be exercised with the previous opinion of the SBFI – Supervisory Agency regarding banking entities and other financial institutions



Authority to preserve the stability of the Financial Sector

- The Bank shall have the power to:

Provide credits to banking entities in the event of **urgency due to temporary liquidity shortage**, for a term not exceeding 90 days (Last Resort Lending function; include loans or REPO transactions);

Ensure payment of sight deposits or other sight obligations originated in banks, in case of bankruptcy agreements or forced liquidation of said entities, granting them credits or acquiring their assets, but subrogating in the rights of said bank creditors;

Participate in such agreements, as a term creditor, being empowered even to waive part of the debts



Authority regarding international transactions

- The Bank has the authority:

To **borrow for all types of credits abroad**, through credit lines, loans or in any other manner;

To **issue debt securities** which shall comply with terms and conditions authorized for the corresponding issue and place them abroad

To **concede loans** to foreign states, foreign central banks or banking institutions, foreign or multilateral financial entities, provided that the objective of the said loans is to assist in the fulfillment of the purposes of the Bank



Authority regarding international transactions

- **To receive deposits** from, or **open checking accounts both in CLP and foreign currency** to foreign central banks or banking institutions or international financial entities, and foreign states
- **To keep, manage and use its international reserves**, both within the country and abroad. The Bank shall have the authority to pledge such reserves as security of compliance with its obligations
- **Participate in foreign or international organizations** and to engage in business transactions with them



Basics for Foreign Exchange Regulations



CBC Authority regarding FX transactions according to the Act

- To **directly engage in and to regulate foreign exchange transactions, in order to fulfill its legal purpose** (i.e. purchase and sale foreign currency (FX); issue notes payable or denominated in FX; agree derivative transactions or hedge agreements)
- Likewise, the Bank may **regulate foreign exchange transactions setting limitations and restrictions** seeking to fulfill said legal purpose, by means of **Council resolutions**



The Act has the principle of “foreign exchange freedom” embedded

“Any person may freely engage in foreign exchange transactions”.

- Previous legal regime contemplated the opposite principle, establishing that FX operations should be performed with the CBC or be expressly authorized by it (“FX Monopoly” granted to the Bank)



The Act has the principle of “foreign exchange freedom” embedded

- “Any person may freely engage in foreign exchange transactions”.
- Foreign exchange transactions are defined as: **buying and selling foreign currency** and, in general, **any act or agreement that creates, modifies, or extinguishes a obligation payable in such currency, even if no transfer of funds to or from Chile are actually involved.**

For purposes of the law, **foreign currency is understood as: banknotes or coins of foreign countries, whatever their denomination or characteristics, and bills of exchange, letters of credit, payment orders, notes, drafts and any other document that provides evidence of an obligation payable in such currency.**

In addition, **also are considered as foreign exchange transactions the transfers or transactions of gold or of instruments representing gold**, provided that they refer to gold objects that by their nature are suitable to serve as a means of payment, even if no transfer of funds or gold to or from Chile are actually involved.

- Regardless the principle of foreign exchange freedom, the Central Bank is authorized by its law to impose exchange **limitations** and **restrictions**.



The Act has the principle of “foreign exchange freedom” embedded

- **Principle of extraterritoriality**
- The effects of foreign exchange transactions entered into abroad, for their performance in Chile, shall be subject to Chilean law.
- **Principle of specialty**
- FX regulatory powers, shall be understood to be without prejudice to legal provisions regarding FX operations executed under especial regimes regarding certain forms of Foreign Investments, such as:

Decree Law 600 of 1974 (**Foreign Investment Statute**, recently abrogated, but with Contracts still in force, subscribed between the State and the Investor);

Decree Law 1089 of 1975 (**Oil Exploration and Exploitation Contracts subscribed with the State**);

Decree Law 1349 of 1976 (Legal Statute for the **Chilean Cooper Commission**)

Decree Law 1350 of 1976 (**Chilean Cooper Corporation (CODELCO)**);

Decree Law 1557 of 1976 (**Legal Statute for the Chilean Nuclear Commission**)

Law 18.156 (Payments required for Pension Purposes regarding salaries paid to **foreign technicians hired in Chile**) .



Foreign exchange *limitations* do not prevent transactions from being conducted

- **FX limitations.** Notwithstanding the foregoing, the Bank may:

Require that transactions of **specified FX operations be reported in writing** using prescribed forms (Article 40);

Decide that the following transactions are to be conducted exclusively within the **Formal Exchange Market (FEM)** (Articles 41 and 42);



Foreign exchange *limitations* do not prevent transactions from being conducted

1. The **repatriation of foreign currency into the country and its sale for Chilean currency**, representing the proceedings from exports of goods and services, and, generally, payments accrued abroad by individuals or entities resident in Chile
2. **Payments in foreign currency abroad** of imports of goods or services, or in general, any other payment to persons not having residence in Chile
3. The **remittance of foreign currency** for purposes of investments, capital contributions, loans or deposits abroad
4. The **sale**, either total or partial, in Chilean currency, **of the foreign currency received, whatever its origin**, by persons having their residence in Chile, as a consequence of acts or transactions conducted in Chile or abroad



Foreign exchange *limitations* do not prevent transactions from being conducted

- **Section 42.** If a transaction is deemed to be conducted exclusively within the FEM, it shall not be carried out by other means, whether in Chilean currency or by other assets, unless expressly authorized by the Bank.
- The Bank may require the documentation and set forth regulatory provisions necessary to supervise and secure the compliance of the obligations prescribed.



FEM, market structure

- The FEM is formed by all the banks authorized to operate in Chile and by some entities that specifically request authorization to the Central Bank to do so, provided that they met the regulatory and prudential requirements set forth by the CBC.

Currently, there are **10 participants of the FEM that are non-bank entities (stock brokers and securities dealers, supervised by the Securities and Insurance Superintendence).**

There are no bureau of exchange participating in the FEM.

Any person or financial institution may engage in foreign exchange transactions with FEM entities, without requiring previous approval of the CBC.

- The Bank must adopt the necessary measures to ensure that the FEM is made up of a number of persons or entities large enough to allow its functioning under appropriate competitive conditions.



FEM, market structure, Section 44

- The rate of exchange in the FEM shall be that **freely agreed between the contracting parties**.
- CBC shall publish daily the rate of exchange of foreign currencies generally accepted in the international exchange markets ("**Observed Dollar Exchange Rate**"), based upon the transactions made in the FEM in the immediately preceding business day and, if appropriate, upon the reports it may obtain from foreign market records.



Foreign exchange restrictions do have a more direct effect over foreign exchange transactions

- **Articles 49 and 50.**
- **Currently the Central Bank is not applying any foreign exchange restriction.** However, it is allowed to impose the following measures, in accordance with the Act.
- **These FX restrictions only can be applied if they are deemed to be necessary in order to preserve currency stability or for balance of payment reasons.** Their application should not exceed one year (although the period can be renewed for the same period).
- It must be adopted by a **Council Resolution** approved by the majority of all members, subject to **veto power** conferred to the Minister of Finance, that **could be superseded** by the favorable vote of all members.



Foreign exchange restrictions do have a more direct effect over foreign exchange transactions

- **FX Restrictions.** Set the following limits to FX transactions conducted, or those that should be conducted, in the Formal Exchange Market:
 1. Obligation of **repatriation of foreign currency** into the country, **and conversion into Chilean currency**, of certain payments accrued abroad by residents in Chile (from exports, any other FX payment accrued abroad or FX obtained by a resident); If conversion of foreign currency relates with **investments, capital contributions or credits from abroad**, CBC shall grant access to the FEM for compliance with payment or remittance obligations arising therefrom.
 2. Determine that the credits, deposits or investments in foreign currency originating or to be sent abroad be subject to a **reserve requirement**
 3. Establish that certain payments or remittance obligations shall require **prior authorization** from the Bank



Foreign exchange restrictions do have a more direct effect over foreign exchange transactions

4. Rule that the entities which form the Formal Exchange Market **may execute only the foreign exchange transactions expressly authorized** by the Bank, and only in the manner established thereby;

5. **Set limits, under generally applied criteria, to the holdings** in foreign currency or investments denominated in foreign currency that FEM entities may maintain within the country or abroad.



Other relevant issues related to foreign exchange regulations

- **Compliance of the foreign exchange regulations of the Central Bank** has to be verified, in their respective areas of competence by the supervisors of banks, securities and insurance, pensions, the internal revenue service and customs. Also, such agencies are obliged to **issue the pertinent instructions to implement said regulations**, within the scope of their powers.
- In any case, **CBC may directly exercise supervision** regarding foreign exchange regulations.
- **Infringements on foreign exchange regulations can be penalized with a charge up to twice the amount of the transaction.** There's a specific **commission within the Central Bank** to deal with these situations. (Section 58 Act)



Other relevant issues related to foreign exchange regulations

- **Criminal sanction:** any person making a **willful misrepresentation** in any document presented to the Central Bank of Chile or **in foreign exchange operations regulated by its Act**, shall be punished by the criminal courts of law with a penalty of imprisonment (541 days to 5 years). (Section 59 Act)
- Lastly, the legal powers on the Central Bank to apply foreign exchange measures have been preserved in all the **Free Trade Agreements** that Chile has subscribed during the last 15 years.



Compendium of foreign exchange regulations of the Central Bank of Chile (CFER)

The opinions expressed in this document are those of the author and do not necessarily represent the Central Bank of Chile or its Board. The author acknowledges the contribution of Pablo Furche, Senior Economist of the Bank, to this Section.



The CFER and its Manual of Forms and Procedures

- The CFER sets which foreign exchange limitations are currently in place and the Manual specifies in depth how they are to be applied.
- Those operations that are not specifically regulated in the CFER are allowed to be conducted freely because of the principle of “foreign exchange freedom”. For instance, money exchange for tourists.
- The Central Bank has decided to regulate not all but the most relevant foreign exchange operations. For instance, foreign trade, investment of non-residents in Chile, investment of Chileans abroad and exchange derivatives.
- All operations included in the CFER have to be reported to the Central Bank and be conducted through the Formal Exchange Market (except foreign trade operations).
- Given the current exchange policy regime, the information received by the bank has mainly statistical purposes.



The CFER has 13 chapters. 3 of them are “structural”, and the remaining 10 deal with specific types of operations

The screenshot displays the website of the Banco Central de Chile, specifically the page for the Compendio de Normas (CFER). The browser address bar shows the URL: <http://www.bcentral.cl/normativa/cambio-internacional/compendio-normas/index.htm>. The page title is "Normativa y reglamentación".

On the left side, there is a navigation menu with the following items:

- Transparencia
- Estudios
- Conferencias y Seminarios
- Estadísticas Económicas
- Publicaciones
- Operaciones Financieras
- Sistemas de Pagos
- Billetes y Monedas
- Sala de Prensa
- Información para el Banco Central
- Licitaciones y cotizaciones
- Servicios especiales
- Sitios de interés

The main content area is titled "Documentos en formato Adobe PDF (Se requiere Adobe® Reader® 5.0 o superior)". Below this, there is a link: "Sus consultas al correo: informacioncambiaria@bcentral.cl".

The main content is organized into a table with two columns: "CAPÍTULO" and "PDF".

CAPÍTULO	PDF
Portada Compendio	Portada
Indice de contenidos	Indice
Disposiciones Generales.	Capítulo I
De las limitaciones cambiarias.	Capítulo II
Normas relativas a las personas jurídicas autorizadas para formar parte del Mercado Cambiario Formal distintas de las empresas bancarias.	Capítulo III
Información cambiaria de las operaciones de exportación.	Capítulo IV
Información cambiaria de las operaciones de importación.	Capítulo V
Normas y procedimientos para la canalización de operaciones a través del Convenio de Pagos y Créditos Recíprocos (ALADI).	Capítulo VI
Operaciones de cambios internacionales realizadas por las compañías de seguros y reaseguros establecidas en Chile.	Capítulo VII
Normas relativas a operaciones de cambios internacionales no reguladas en capítulos específicos de este compendio.	Capítulo VIII
Operaciones con Instrumentos Derivados.	Capítulo IX
Garantías otorgadas en moneda extranjera, por o a favor de personas domiciliadas o residente en Chile, distintas de las empresas bancarias. (Derogado por circular 867 del 03/01/2008 con el acuerdo 1382-06-071227)	Capítulo X
Normas y condiciones generales para las convenciones a suscribir con fondos de inversión de capital extranjero, Ley N° 18.657.	Capítulo XI
Inversiones, depósitos y créditos que personas domiciliadas o residentes en Chile, que no sean empresas bancarias realicen u otorguen al exterior y operaciones efectuadas al amparo del Título XXIV de la Ley N° 18.045.	Capítulo XII
Normas aplicables a los créditos e inversiones que realicen las empresas bancarias establecidas en Chile.	Capítulo XIII
Normas aplicables a los créditos, depósitos, inversiones y aportes de capital provenientes del exterior.	Capítulo XIV

At the bottom of the page, there is a footer section for the Banco Central de Chile, including the logo, address (Dirección: Agustinas 1180, Santiago, Chile), phone number (Fono Mesa Central: (56 2) 670 2000), and links for "Acerca del Sitio", "Información de Contacto", and "Condiciones de Uso".



The “structural” chapters define the scope of the CFER and the conditions that entities must fulfill in order to become FEM participants

- Chapter I: General Provisions

Definitions (foreign exchange limitations, foreign exchange operations, foreign currency).

Identity verification of participants in foreign exchange transactions.

Chapter I of the Manual contains the codes of foreign exchange operations and a thesaurus.

- Chapter II: Foreign Exchange Limitations

The following operations have to be **reported to the Central Bank and conducted through the FEM**: transactions performed by insurance companies and banks, credits and deposits to and from Chile, derivatives.

Operations that have to **conducted through the FEM** (but not necessarily reported to the Central Bank): transactions related to the ALADI's Payments Agreement, copyright, patents and trademarks, among others.

Operations that have to be **reported to the Central Bank** (but not necessarily conducted through the FEM): foreign trade, transactions performed by maritime and air companies, transactions related to credit and debit cards.

- Chapter III: Entities authorized to become FEM participants (non banks)

Juridical format requirements, capital and integrity.



Exports



Exports

Capítulo IV
Hoja N° 1.-

CAPITULO IV

INFORMACIÓN CAMBIARIA DE LAS OPERACIONES DE EXPORTACION

1. Los exportadores que hayan efectuado exportaciones por un valor F.O.B. igual o superior a US\$ 50 millones anuales, deberán informar al Banco Central de conformidad a lo dispuesto en el Capítulo IV del Manual.

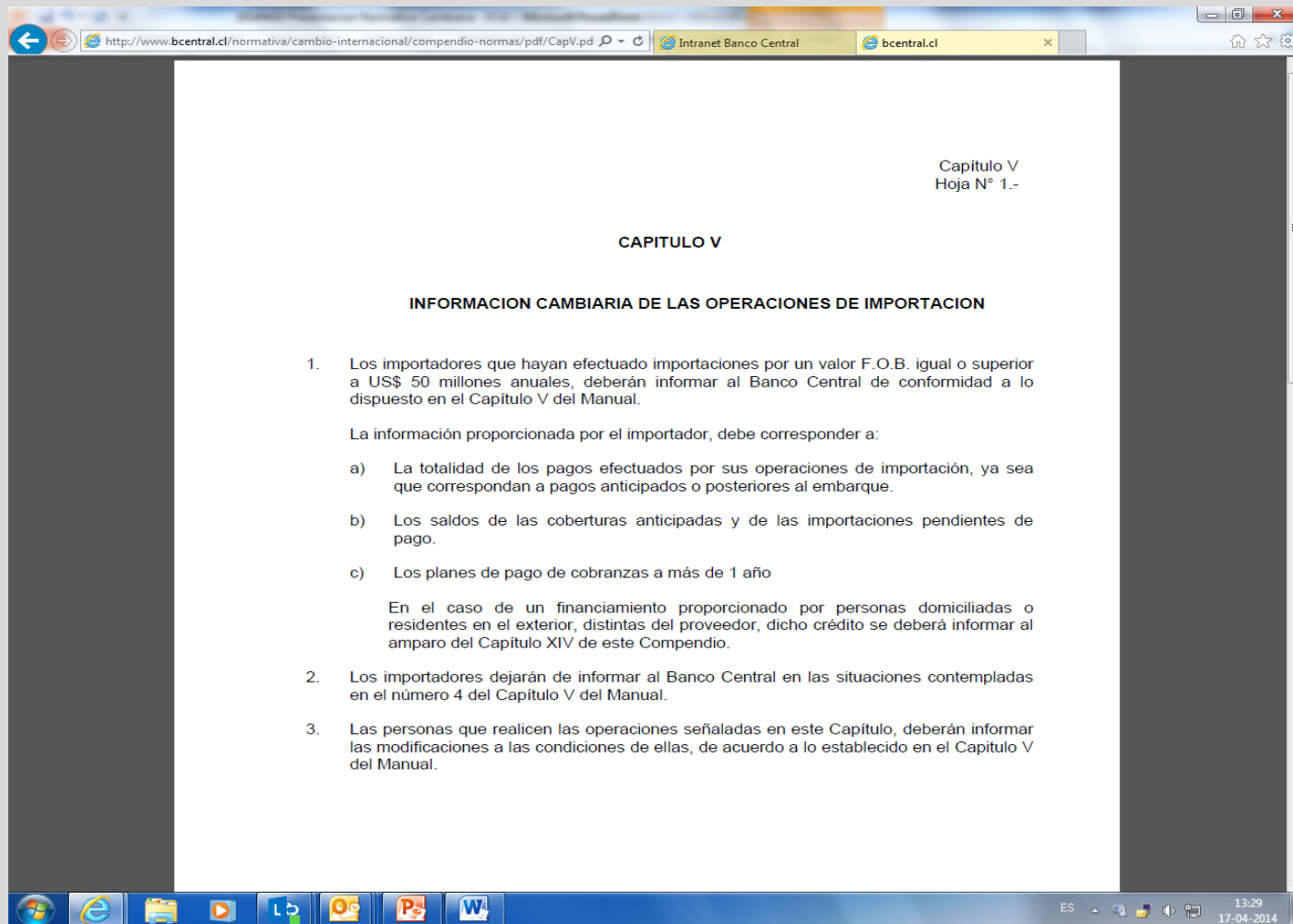
La información proporcionada por el exportador debe corresponder a:
 - a) La totalidad de las divisas obtenidas por sus operaciones de exportación, ya sea que correspondan a pagos anticipados o posteriores al embarque.
 - b) Los pagos de los Anticipos de Comprador.
 - c) Los saldos de las exportaciones y de los anticipos de comprador pendientes de pago.
2. Para la información que corresponda proporcionar, deberán considerarse las modalidades de venta convenidas por el exportador, las que se encuentran contenidas en el Capítulo IV del Manual.
3. Los exportadores dejarán de informar al Banco Central en las situaciones contempladas en el número 4 del Capítulo IV del Manual.
4. Si las divisas recibidas como pago de una exportación no son retornadas al país y corresponden a exportaciones efectuadas por empresas receptoras de un proyecto de inversión en el cual se haya convenido el régimen especial previsto en la letra b) del N° 3 del artículo 11 bis del D.L. N° 600 de 1974 y sus modificaciones, deberán informar al Banco de acuerdo a lo establecido en el respectivo contrato y sus modificaciones.
5. Las personas que realicen las operaciones señaladas en este Capítulo, deberán informar las modificaciones a las condiciones de ellas, de acuerdo a lo establecido en el Capítulo IV del Manual.



Imports



Imports

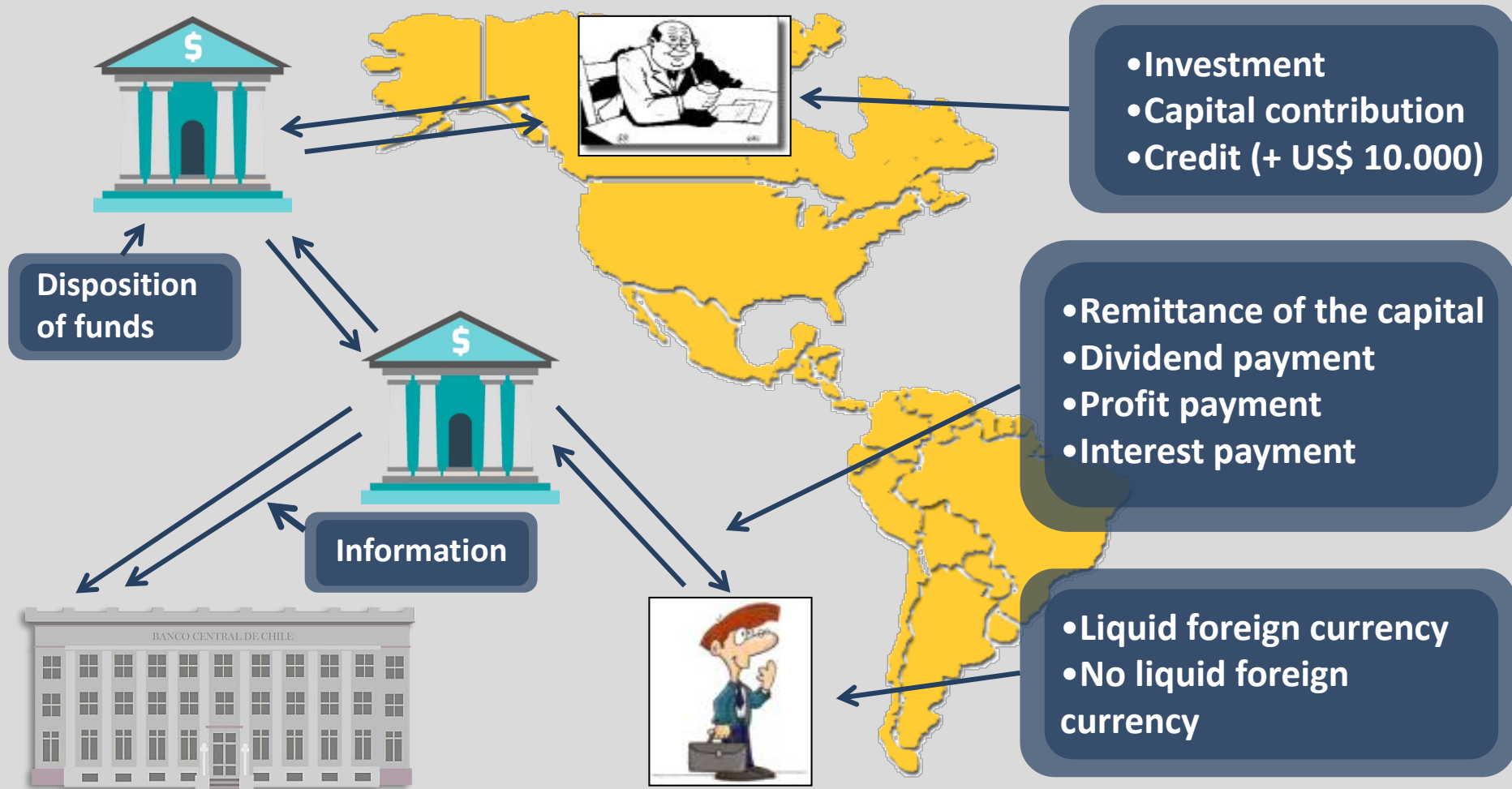


Chapter XIV: Investments of non-residents in Chile

- Scope: Transactions exceeding USD10,000 of Chilean residents.
- Definitions: Investment, deposit, credits, funds disposition, institutional investors.
- Those transactions have to be reported following the instructions of Chapter XVI of the Manual.
- In addition, changes on terms and conditions of the transactions also have to be reported to the Central Bank.
- There is a specific section dealing with DL600.



Chapter XIV of the Compendium of Foreign Exchange Regulations of the CBC

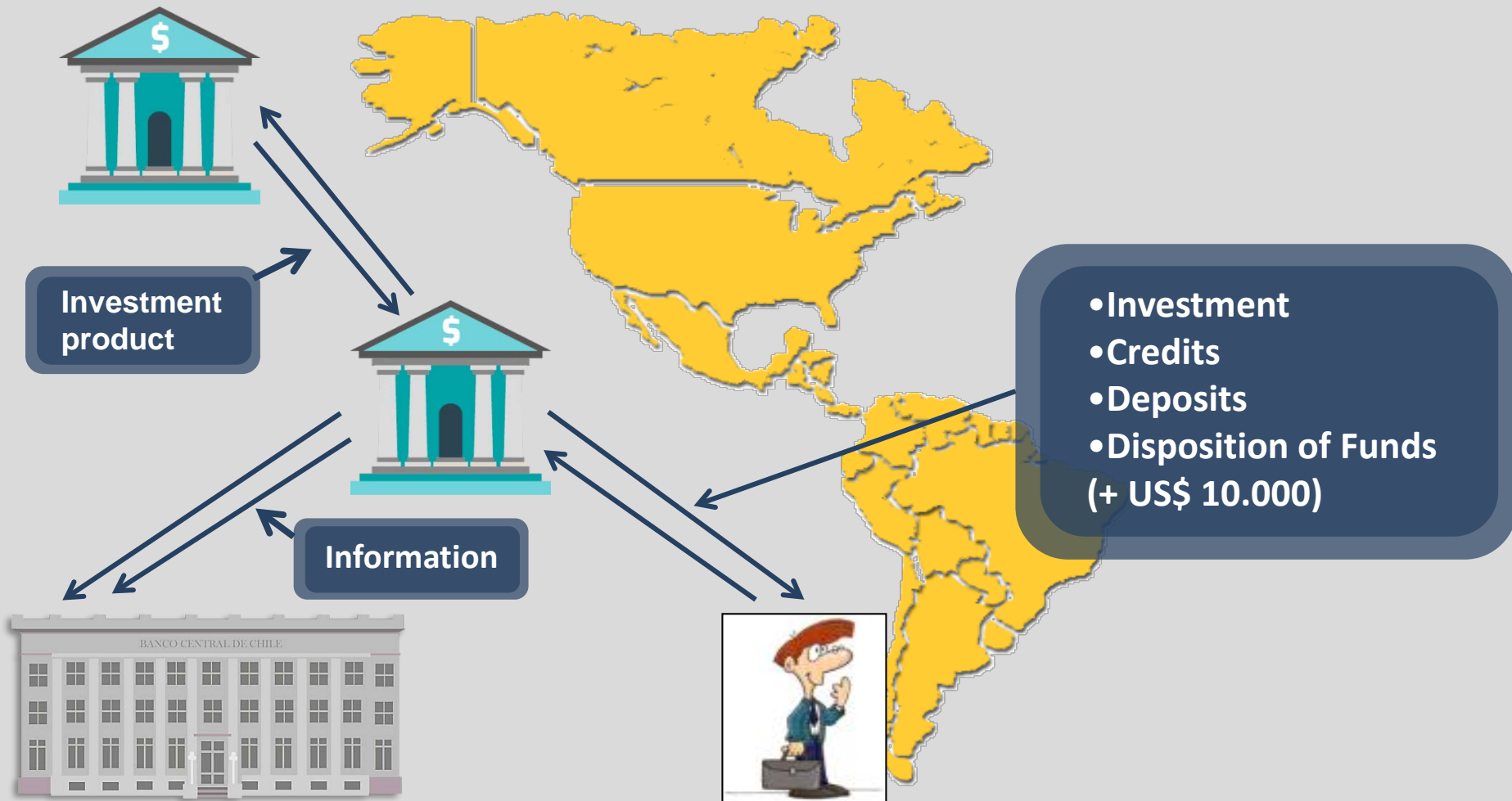


Chapter XII: Investments of residents made abroad

- Scope: Transactions exceeding USD10,000 of Chilean residents.
- Definitions: Investment, deposit, credits, funds disposition, institutional investors.
- Those transactions have to be reported following the instructions of Chapter XII of the Manual.
- In addition, changes on terms and conditions of the transactions also have to be reported to the Central Bank.



Chapter XII of the Compendium of Foreign Exchange Regulations of the CBC



Chapters XII and XIV CFER operations description

The opinions expressed in this document are those of the author and do not necessarily represent the Central Bank of Chile or its Board. The author acknowledges the contribution of Cristián Carmona, Senior Counsel of the Bank, to this Section



Chapter II of the Compendium of Foreign Exchange Regulations (CFER) of the CBC

Preamble,

Chapter II of the CFER specifies the transactions subject to foreign exchange limitations on a non-discriminatory basis.

In particular, Letter A of this Chapter specifies which transactions have to be conducted through the Formal Exchange Market in Chile (FEM) and/or reported to the Central Bank of Chile:

Credits, deposits, investments and capital contributions from abroad (Chapter XIV CFER).



Chapter I N° 10 of the Compendium of Foreign Exchange Regulations of the CBC

- Chapter I of this Compendium establishes that the entities of the Formal Exchange Market in Chile (FEM) must verify properly, **the identity and RUT (Tax Payer Number) of the persons performing foreign exchange operations through the FEM**, and the identity and RUT of the person or persons who, on behalf of them, acting in that transaction.
- Those entities must also **reasonably verify** that the documentation submitted to carry out the relevant transaction corresponds to it.
- These process must be carried out in accordance with standard procedures applicable to those entities, including instructions and recommendations related with the **KYC**.

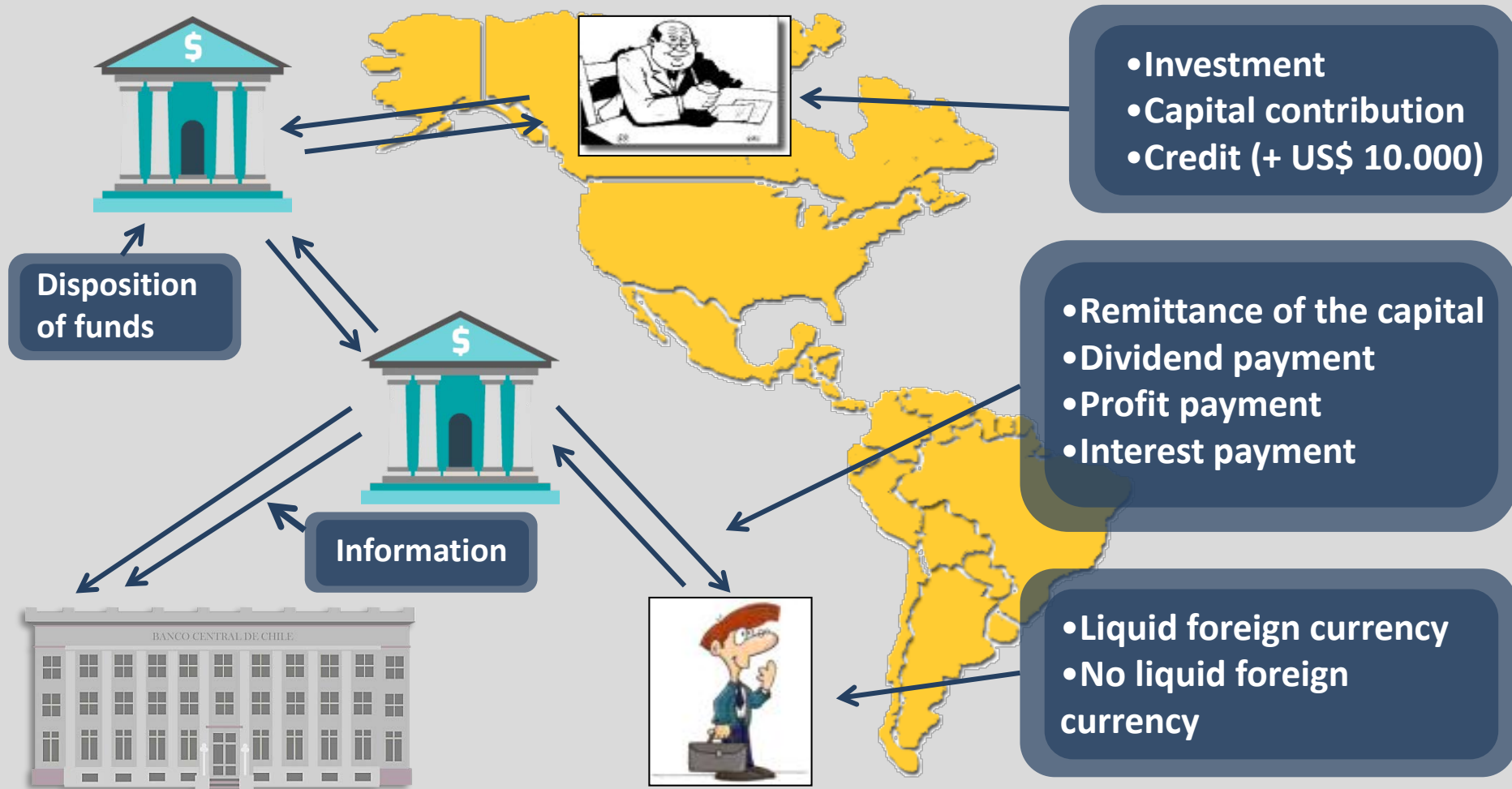


Chapter XIV of the Compendium of Foreign Exchange Regulations of the CBC

- Chapter XIV provides the overall foreign investment regime in the country.
- These rules shall be applicable to credits, deposits, investments or capital contributions over USD 10,000 or the equivalent thereof in another foreign currency.
- The operations referred to in this Chapter shall be governed by the provisions hereof in effect on the date: i) of entry of foreign currency, being these liquidated or not; ii) where applicable, of their use abroad; iii) on the date on which the corresponding payment or remittance is made (i.e. interests, adjustments, profits).
- Foreign currency entering the country generated by operations set forth in this Chapter shall be conducted through the Formal Exchange Market, except in the event that the foreign currency is used directly abroad, or when the payment obligation is met abroad with other resources.



Chapter XIV of the Compendium of Foreign Exchange Regulations of the CBC



Foreign exchange transactions regulated under Chapter XIV of the CBC

Chapter XIV establishes the applicable regulation overall related with the following foreign exchange transactions:

Credits:

Any act, agreement or contract by reason of which **one of the parties thereto delivers or undertakes to deliver foreign currency from abroad to another party, with domicile or residence in Chile, which assumes the obligation of returning the same amount of currency at a different moment**, with or without interest or adjustment, such as: loans; credit lines; discounts or re-discounts of securities; and credits and overdrafts on bank or mercantile current accounts.



Foreign exchange transactions regulated under Chapter XIV of the CBC

The concept of **credit** also includes:

- Those provided through the placement abroad of bonds, convertible or not, issued by persons domiciled or resident in Chile, payable in foreign currency, whether expressed in Chilean pesos or “*Unidades de Fomento*”;
- Credits expressed or denominated in Chilean pesos or in “*Unidades de Fomento*”, payable in foreign currency;
- The “associated credits” referred to in letter d), article 2 of Decree Law 600 of 1974;
- Those foreseen within the assumptions of No. 3 of Article 11 bis of the aforementioned Decree Law;
- Credits or “purchaser advances” used to finance exports;
- Those operations for which foreign currency is used fully or partially abroad, to pay for other obligations contracted by the borrower.



Foreign exchange transactions regulated under Chapter XIV of the CBC

Deposits:

Acts, agreement or contracts by reason of which **one of the parties delivers foreign currency from abroad or the proceeds of its sale in Chile to another, domiciled or resident in Chile**, who acquires the ownership of them in the form of a deposit and **undertakes to return these funds at a time other than the moment of delivery.**



Foreign exchange transactions regulated under Chapter XIV of the CBC

Investments:

- Any act, agreement or contract by reason of which **a party acquires, using foreign currency from abroad or the proceeds of its sale in Chile**, the ownership or the right to use, enjoy, possess or merely bear securities, commercial papers, shares, corporate rights **or any other kind of securities, real estate or chattel property.**
- Likewise, it is considered investment the acquisition of shares in open corporations or quotas in Investment Funds, domiciled in Chile, whose purpose is the conversion of these shares or quotas into securities representatives of the same, traded in foreign markets, shall be considered as investments. The form of those securities, as well as the manner in which they shall be traded or quoted, shall be governed by the regulations of the country in which those actions are carried out; and the corresponding conversion of securities into shares or quotas or vice versa, by the provisions established under Chilean law.



Foreign exchange transactions regulated under Chapter XIV of the CBC

Capital Contributions:

Any act, agreement or contract by reason of which **a party delivers foreign currency from abroad or the proceeds of its sale in Chile to constitute or increase the capital of a legal entity, domiciled in Chile**, as well as the capitalization therein of foreign currency obligations contracted abroad.



Other important concepts of Chapter XIV

Foreign Currency Coming From Abroad:

- It will be understood that foreign currency corresponding to credits, investments and capital contributions **comes from abroad** whenever the obligation from which they originate or from which they cause, **arise or proceed under any act, agreement or contract, named or unnamed,**
- gives or may give origin to an obligation to pay or to remit foreign currency abroad on behalf of an individual domiciled or resident in Chile,
- or gives or may give origin to the right to transfer abroad capital invested or contributed and its respective benefits thereof.



Other important concepts of Chapter XIV

Disposition of Funds:

Any act, agreement, or contract, by reason of which **the party domiciled and resident in Chile uses** funds in foreign currency located abroad at their disposal, for any purpose to carry out operations covered by this Chapter.



Provisions applicable to foreign exchange transactions regulated under Chapter XIV

The operations referred to in this Chapter XIV shall be governed by the provisions **hereof in effect on the date:**

- a) of entry of foreign currency, being these liquidated or not;
- b) where applicable, of their **use** abroad;

Payments or remittances of foreign currency that must be effected by reason of operations referred to in this Chapter, including interests, adjustments, profits and other benefits that these operations may generate, shall be governed by the provisions in effect on the date on which the corresponding payment or remittance is made.



“Use” of the foreign currency abroad

In the event that the foreign currency **is used directly abroad**, the **borrower, the investor, or the company receiver** of the capital contribution shall report this circumstance to the Central Bank of Chile as set forth in Chapter XIV of the Procedural Rules.

This concept refers to two situations regulated under Chapter XIV:

- a) when a persons domiciled or resident in Chile used fund abroad (i.e., a debtor pays a credit abroad); and
- b) the especial case when the foreign currency is maintained abroad under regulations applicable to operations covered by No. 3, Article 11 bis, Decree Law 600 of 1974.



Other obligations established under Chapter XIV

Obligation to report credit operations, whose individual amount is equal to or exceed USD 1,000,000 or the equivalent thereof in other foreign currencies:

Without prejudice to the information required in the corresponding Form, the participants in such operations should report -which must be submitted in writing- to the Central Bank of Chile the respective foreign exchange transaction.



Other obligations established under Chapter XIV

Obligation to report other credit operations, whose individual amounts exceed USD 100,000 or the equivalent thereof in other foreign currencies:

Persons domiciled or resident in Chile, who contract credits that give or may give origin to a direct obligation to pay or to remit foreign currency abroad, that are not covered by this Chapter XIV and are not governed by other provisions in this Compendium or the Compendium of Financial Regulations of the CBC, shall report -which must be submitted in writing- those credits as well as its payments to the Central Bank of Chile.



Other obligations established under Chapter XIV

Obligation to report in writing to the Central Bank of Chile the following amendments to the corresponding acts, agreements or contracts:

- **Substitution** of the creditor, borrower, depositor, deposit holder, investor, contributor or receiver of the capital contribution;
- Total or partial **cession** of credits or social rights to investment or capital contributions;
- Amendment to the company's **legal name**;
- **Merger** or division of firms;
- **Payment plan** or schedule;
- Financial conditions and/or amendments to special credit clauses as reported;
- Total or partial **capitalization** of a credit or other payment obligations; and
- **Changing from investment to capital contribution or viceversa**, including foreign investment reported under the above cited Decree Law 600, which has not been formalized as such.



Final paragraph of the section 42 of the Constitutional Organic Act of the CBC in relation to Chapter XIV

Section 42 (final paragraph) point out that the corresponding transaction that require to be executed in the Formal Exchange Market, shall not be carried out, whether in Chilean currency or by means of other assets, unless expressly authorized by the Central Bank of Chile.



Final paragraph of the section 42 of the Constitutional Organic Act of the CBC in relation to Chapter XIV

Resolution number 1198-02-050526 adopted by the Board of the Central Bank of Chile authorizes the following transactions:

- Investments can be made through the transfer of shares or rights in companies incorporated abroad.
- Capital contributions can be made in shares or rights in companies incorporated abroad.

-In any case, the remittance of capital, dividends or profits must always be made in foreign currencies-

Likewise, it is considered as a **capital contribution**, the capital contributed by the foreign investor to companies formed in accordance with Section 41D of the Income Tax Law in Chile, is that capital finds out (i) in shares, or (ii) social rights of companies domiciled abroad, owned by persons not domiciled or resident in Chile.



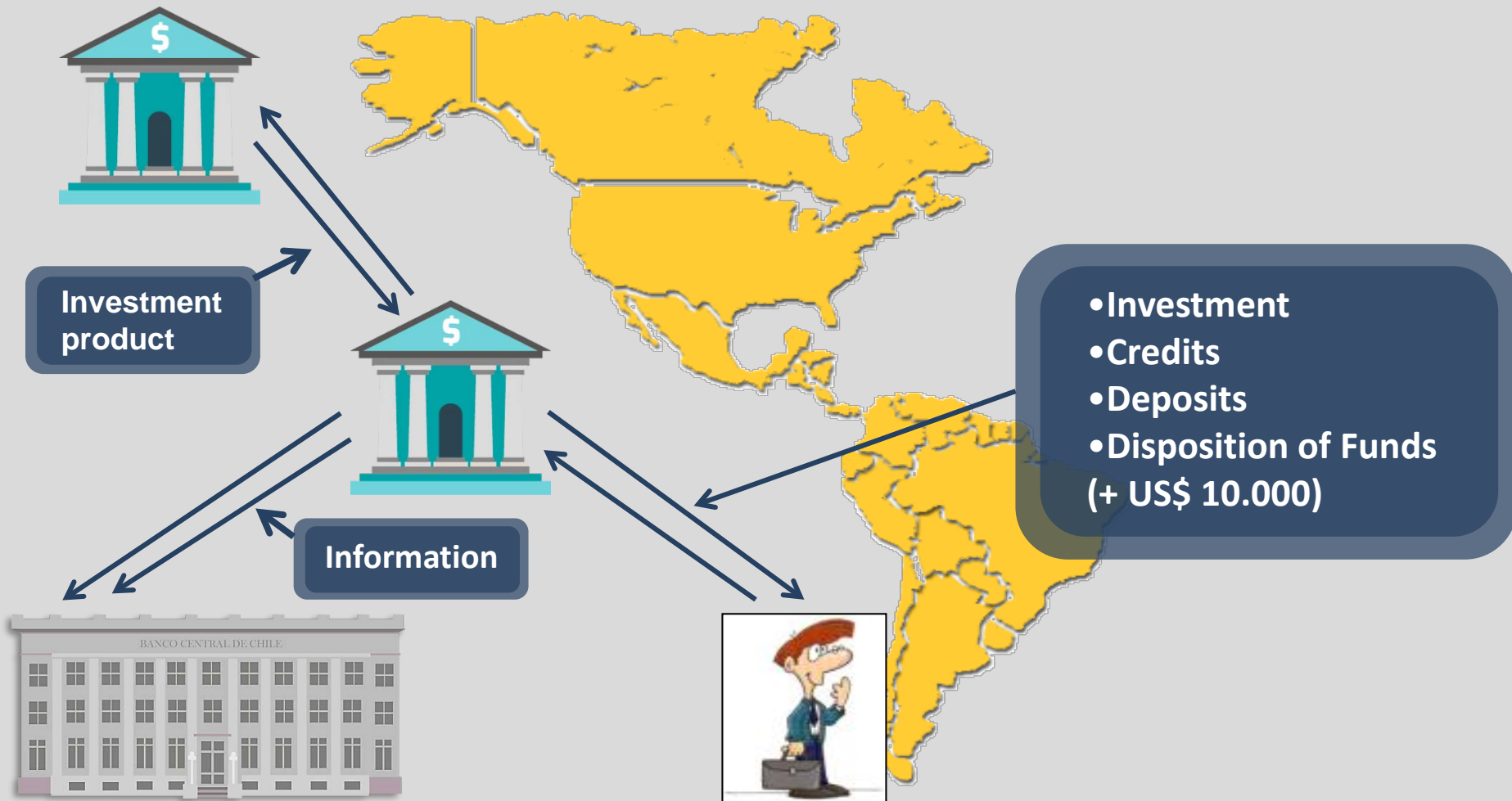
Chapter XII of the Compendium of Foreign Exchange Regulations of the CBC

- This Chapter contains the provisions applicable **to the remittance of foreign currency or available funds for amounts over USD 10,000** or the equivalent thereof in another foreign currency, **that persons domiciled or resident in Chile***, **remit abroad -or used abroad- in order to make investments, grant loans or deposits abroad.**
- The foreign exchange operations referred to in this Chapter **must be reported to the Central Bank of Chile and made through the Formal Exchange Market in Chile** (payments or remittances of foreign currency).

*Including Pension Funds, Insurance Companies, Mutual Funds, Investment Funds, Unemployment Fund and National reinsurers / This regulation it also applies to investments made in order to acquire foreign securities.



Chapter XII of the Compendium of Foreign Exchange Regulations of the CBC



Foreign exchange transactions regulated under Chapter XII

Chapter XII establishes the applicable regulation overall related with the following foreign exchange transactions:

Investments:

Any act, agreement or contract by reason of which **a party domiciled or resident in Chile acquires abroad**, the ownership or the right to use, enjoy, possess or merely bear securities, shares, corporate rights, capital contributions, commercial paper, foreign securities **or any other kind of securities, whether such acts, agreements or contracts concluded in the country or abroad.**



Foreign exchange transactions regulated under Chapter XII

Deposits:

- Any acts, agreement or contracts by reason of which a **party domiciled or resident in Chile delivers foreign currency to a depositary domiciled or resident abroad, which assumes the obligation of returning these funds,** within less than 30 calendar days, as much in the same currencies or in other foreign currencies, with or without interest or readjustments.
- Likewise, are consider “deposits” for purposes of Chapter XII, those Institutional Investors in Chile made abroad in any term or in current accounts.



Foreign exchange transactions regulated under Chapter XII

Credits:

Any act, agreement or contract by reason of which **a party domiciled or resident in Chile delivers foreign currency to another party, with domicile or residence abroad, which assumes the obligation of returning the same amount of currency at a different moment**, with or without interest or adjustment, **such as:** loans; credit lines; discounts or re-discounts of securities, whether or not they implicitly involve the responsibility of the endorser; and credits and overdrafts on bank or mercantile current accounts.



Other important concepts of Chapter XII

Disposition of Funds:

Any act, agreement, or contract, by reason of which **the party domiciled and resident in Chile uses** funds in foreign currency at their disposal, to any title abroad, for any purpose to carry out operations covered by Chapter XII.



Final paragraph of the section 42 of the Constitutional Organic Act of the CBC in relation to Chapter XII

Section 42 (final paragraph) point out that the corresponding transaction that require to be executed in the Formal Exchange Market, shall not be carried out, whether in Chilean currency or by means of other assets, **unless expressly authorized by the Central Bank of Chile.**

Cases authorized by the Central Bank of Chile

Resolution number 1198-02-050526

- It is authorized investments abroad can be made through the contribution or transfer of shares or rights in companies incorporated in Chile that held by the investor.
- It is considered as an investment, investments abroad that are a result of the capital contributed by the foreign investor in shares or social rights of companies domiciled abroad, owned by persons not domiciled or resident in Chile, according to the Section 41D of the Income Tax Law in Chile.



Final paragraph of the section 42 of the Constitutional Organic Act of the CBC in relation to Chapter XII

Cases authorized by the Central Bank of Chile...

- NCG N° 193 enacted by the Superintendency of Securities and Insurance (SVS), 2006: Authorizes foreign issuers of securities are registered in the National Securities Registry maintained by the SVS, in order to register the bond issue in Chile, which are governed by the provisions contained in Title XVI of Law 18,045, whose public offering will be directed exclusively to qualified investors.
- The **bond issues may be made by persons domiciled and residing abroad**, in the currency or unit adjustment that is defined in the bond indenture. This bonds issued and registered in accordance with these rules **may be payable in Chilean pesos** or *Unidades de Fomento*.



Final paragraph of the section 42 of the Constitutional Organic Act of the CBC in relation to Chapter XII

Cases authorized by the Central Bank of Chile...

- It is important to note that, according to the general foreign exchange regulations of the CBC, the issuance of bonds by a person domiciled or resident abroad can only be made in foreign currency (arts. 40 and 42 No. 4 in conjunction with Chapters II and XII CFER).
- For this reason, **the authorization of the issuance of bonds in pesos or other or unit adjustment in the local market and its acquisition by persons domiciled or resident in Chile, required the resolution of the Board of the Central Bank of Chile**, under the terms of the final paragraph of section 42 of it Constitutional Organic Act (COA).





CBC Authority and Operations regarding Monetary and Foreign Exchange Markets Part II



Agenda II

- 1. Foreign exchange restrictions applied in the past**
- 2. Measures approved to provide liquidity in local and foreign currency to the Banking System during 2008-2009**



Foreign exchange restrictions applied in the past

Annexes



Different approaches were followed in the '80s and in the '90s, given the different economic scenarios.

- During the '80s, as a consequence of a foreign debt crisis, there was a shortage of foreign currency and therefore the exchange policy was focused on restricting outflows.
- In the '90s, there is a different economic (and legal) situation. Large inflows of capital were directed towards emerging economies in general, and Chile in particular had a relatively high inflation. Therefore, measures aimed at restricting inflows were imposed.
- Between 1991 and 1998 the Central Bank applied an unremunerated reserve requirement ("*encaje*") to inflows of external credits, deposits of non-residents in Chile, portfolio investment and capital APORTES to non-productive companies.
- This *encaje* was modified in several opportunities, partly to avoid its circumvention. The main changes were: rate, duration, types of transactions and thresholds.



Different approaches were followed in the '80s and in the '90s, given the different economic scenarios.

- The applied rate of the *encaje* was set initially at 20%, but most of the decade it was set at 30%. During the last months it was lowered to 10%, before being “reduced to 0%”.
- As for duration, initially the *encaje* was set at 90 days, but it was later changed to 1 year where it remained.
- The type of inflows affected also changed. In the beginning it was applied only to external credits. Then credits related to foreign direct investment were included, and also ADRs. FDI was not charged, as long as it was intended to increase productive capacity.
- Portfolio investment was charged with the *encaje* in 1996.
- Derivatives were not subject to the *encaje*. However, access to the FEM required prior authorization from the Central Bank.



Different approaches were followed in the '80s and in the '90s, given the different economic scenarios.

- As an alternative to the *encaje*, the Central Bank provided the option to pay an “*encaje sustitutive cost*”, which was based on the LIBOR rate plus a spread between 0 and 4%.
- In 1998, the *encaje* was reduced to zero, but it was maintained in the foreign exchange regulation until 2001, when an overhaul of the regulation was made.



The foreign exchange regulations do not operate in a vacuum. They need to be consistent with the broader set of economic policies

- The CBC has always had legal powers to apply foreign exchange measures. While it currently does not apply exchange restrictions or capital controls, this has not always been the case. On the contrary, in the past, the use of capital controls was not unusual.
- When the Act was enacted in 1989, the embedded principle of “exchange freedom” was a very significant change.
- In line with a gradual process of openness of the capital account, coupled with other economic policies (free floating exchange rate, inflation targets, fiscal superavit, etc.), capital controls were eliminated by the end of the 90’s.
- Since then, capital controls have not been applied again. However, the legal powers to do so still remain.
- As a consequence of the liberalization of the capital account, foreign exchange regulations had to be modified. A new “Compendium of Foreign Exchange Regulations” (CFER) was issued in 2001.



Measures approved to provide liquidity in local and foreign currency to the Banking System during 2008-2009

Annexes



Measures adopted to provide liquidity during the subprime crisis

- In the context of a free floating exchange rate regime and monetary policy goals targeting scheme, during 2008 and 2009 the CBC adopted a **program of intervention in the FX market to strengthen the Chilean economy's international liquidity position**, that consisted in increasing in USD 6 billion, its international reserves over a period of eight months.

The program consisted on **daily purchases of USD 50 million in the local market, commencing as of April 14.**

Said program intended to put the Chilean economy on a favorable stand to address turbulences to **better cushion the possibility of further severe and abrupt deterioration of the world economy.**

- The CBC also adopted other complementary measures, described in the Annexes of this section.



Measures approved to provide liquidity in local and foreign currency to the Banking System during 2008-2009

Annexes



Q2 and Q3 - 2008

- April 10: the Board began a program of intervention in the f/x market to **strengthen the Chilean economy's international liquidity position by announcing an increase of USD 8 billion of international reserves over a period of eight months.**

Said program puts the Chilean economy on a favorable stand to address turbulences to better cushion the possibility of further severe and abrupt deterioration of the world economy.

The program consisted on **daily purchases of USD 50 million in the local market, commencing as of April 14.**

- The Board also amended the **Bank's Debt Securities Program** increasing the program in USD 1 billion for the period May 9 – August 8, 2008.



Q3 and Q4 - 2008

- September 29: the **Board announced the end of its reserve accumulation program (USD 5.75 billion)**, together with **start offering the supply of dollar and peso liquidity** through schedules repo and swap operations.
- October 9: the Board allowed financial entities to comply with reserve requirements in foreign currency not only in USD but with other currencies.
- Said measure aimed to provide liquidity to the financial system both in CLP as in USD.



Q4 - 2008

October 10: the Bank announced that it was **expanding the definition of eligible collateral** (term deposits as eligible instrument to undertake **REPO transactions**) and **extending its dollar swap program from one to six months**.

This was **complemented by the Ministry of Finance, which placed time FX deposits** using resources previously deposited overseas and seasonal dollars surpluses in the Treasury bank account.

December 3: in order to provide liquidity at longer terms and guarantee its availability to the market, **the Bank lengthened the terms of its currency swap auctions** from 60 and 90 days to 180 days.

December 10: the Bank announced that (i) the **liquidity provision program via repo and swap operations would be extended** to the end of 2009, and (ii) the implementation of a new complementary liquidity provision mechanism based on secured credit lines, for which the eligible collateral includes securities, Treasury bonds, and bank time deposits, among others.



Q1 - 2009

- April 7: The Board extended the authorization to comply with reserve requirement in foreign currencies other than USD.
- June: the **Ministry of Finance announced the issue of USD 1.7 billion in Treasury Bonds**, to be carried out in the second half of 2009.

The **Central Bank, in turn, decided to adjust its scheduled issues of securities to offset the potential impacts** of the Treasury bond issue, so as to maintain the maturity structure of state-issued instruments in the long part of the curve. To this end, the Bank will offer securities for an amount similar to the Ministry of Finance's issue, at maturities of less than 5 years.

Furthermore, **the Bank announced the repurchase of inflation-indexed securities issued** at 5 and 10 years term, up to USD 1 billion.



Q3 - 2009

- July 9: the Board decided to reduce the monetary policy interest rate by 25 basis points, to 0.50% (annual), and to adopt the following complementary monetary policy measures:

To establish a term liquidity facility (Facilidad de Liquidez a Plazo, FLAP) for banking institutions, whereby it will grant 90- and 180-day liquidity at the prevailing level of the monetary policy rate.

To adjust the program of Central Bank Debt Securities issuance at maturities below one year, in consistency with the aforesaid decision.

To suspend, for the rest of 2009, the issuance of debt instruments maturing in or after one year, corresponding to two-year Central Bank peso-denominated bonds (BCP-2) and one-year Central Bank notes (PDBC-360).





Basic legal framework of the Central Bank of Chile and its functions in the economic Constitutional context

Presentation prepared for the Seminar “Chilean Foreign Exchange and Money Markets. Legal and Regulatory Framework” organized by the Central Bank of Suriname and the Embassy of the Republic of Chile to Suriname.

Pablo Mattar
Normative Head Legal Counsel
LEGAL DEPARTMENT

Opinions expressed herein are of the exclusive responsibility of the author and do not necessarily represent the Central Bank of Chile or its Board.



Central Bank of Chile, October 2016